

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 326 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE C.K.THAKKER and
MR.JUSTICE A.L.DAVE

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1. Whether Reporters of Local Papers may be allowed : YES
to see the judgements?
 2. To be referred to the Reporter or not? : NO
 3. Whether Their Lordships wish to see the fair copy : NO
of the judgement?
 4. Whether this case involves a substantial question : NO
of law as to the interpretation of the Constitution
of India, 1950 of any Order made thereunder?
 5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME-TAX

Versus

WINTEX MILLS LTD

Appearance:

MR BB NAIK WITH MR MANISH R BHATT for Petitioner
MR DA MEHTA & RK PATEL FOR MR KC PATEL
for Respondent No. 1

CORAM : MR.JUSTICE C.K.THAKKER and
MR.JUSTICE A.L.DAVE

Date of decision: 01/09/1999

ORAL JUDGEMENT (Per Thakkar, J.)

1. The following question of law has been referred
for the opinion of this Court :-

"Whether on the facts and in the circumstances of
the case, the Tribunal was right in law in coming

to the conclusion that under the provisions of Section 40A(8) of the I.T. Act, 1961 for the purpose of determining the disallowance, the net amount of interest has to be taken into account?"

2. For the assessment year 1978-79, the assessee debited interest of Rs.13,18,829/-, against which it had received interest of Rs.1,38,205. The Income Tax Officer disallowed interest under Section 40A(8) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") on the gross amount of interest without deducting interest received. In appeal, the Commissioner of Income Tax (Appeals) upheld the decision of the Income Tax Officer. In further appeal by the assessee, the Tribunal held that for determining the disallowance, the net amount of interest should be considered.

3. According to the Tribunal, the point at controversy was whether in order to determine disallowance of interest under Section 40A(8) of the Act, the amount of interest should be taken on gross basis or on net basis. Considering the relevant provisions of the Act and on the basis of "broad commercial principles", the Tribunal observed that it was well settled that making entries in the books is not determinative of the liability and that the liability of an assessee has to be decided on actual income without reference to the method or manner in which the entries are made in the book of accounts. In other words, the expenditure incurred towards interest cannot be determined de hors the interest received. The appeal filed by the assessee was accordingly allowed.

4. Though no direct decision under Section 40A(8) of the Act is brought to our notice, there is a decision of the Honourable Supreme Court *Keshaji Ravji and Co. v. C.I.T.*, 183 ITR 1 on interpretation of Section 40(b) of the Act. Section 40A and Section 40(b) both contain non-obstantive clause. Sub-section (8) of Section 40A, as stood then, read as under :-

"(8) Where the assessee being a company (other than a banking company or a financial company), incurs any expenditure by way of interest of any deposit received by it, fifteen per cent of such expenditure shall not be allowed as a deduction.

Explanation:- In this sub-section,-

(a) 'banking company' means a company to

which the Banking Regulations Act, 1949 (10 of 1949), applies and includes any bank or banking institution referred to in section 51 of the Act;

(b) 'deposit' means any deposit of money with, and includes any money borrowed by a company, but does not include any amount received by the company-

(i) from the Central Government or any State Government or any local authority, or from any other source where the repayment of the amount is guaranteed by the Central Government or a State Government;

(ii) from the Government of a foreign State, or from a citizen of a foreign State, or from any institution, association or body (whether incorporated or not) established outside India;

(iii) as a loan from a banking company or from a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank);

(iv) as a loan from any institution or body specified in the list of the Tenth Schedule or such other institution or body as the Central Government may, having regard to the nature and objects of the institution or body, by notification in the Official Gazette, specify in this behalf;

(v) from any other company;

(vi) from an employee of the company by way of security deposit;

(vii) by way of security or as an advance from any purchasing agent, selling agent or other agent in the course of, or for the purpose of, the business of the company or as advance against orders for the supply of goods or for the rendering of any service;

(viii) by way of subscription to any share, stock, bond or debenture (such bond or debenture being secured by a charge or a lien on the assets of the company) pending the allotment of the said share, stock, bond or debenture, or by way of advance payment of any moneys uncalled and unpaid upon any shares in the company, if such moneys are not repayable in accordance with the articles of association of the company;

(ix) as a loan from any person where the loan is secured by the creation of a mortgage, charge or pledge of any assets of the company (such loan being hereafter in this sub-clause referred to as the relevant loan) and the amount of the relevant loan, together with the amount of any other prior debt or loan secured by the creation of a mortgage, charge or pledge of such assets, is not more than seventy-five per cent of the price that such assets would ordinarily fetch on sale in the open market on the date of creation of the mortgage, charge or pledge for the relevant loan;

(c) 'financial company' means-

(i) a hire-purchase finance company, that is to say, a company which carries on its principal business, hire-purchase transactions or the financing of such transactions; or

(ii) an investment company, that is to say, a company which carries on, as its principal business, the acquisition of shares, stock, bonds, debentures, debenture stock, or securities issued by the Government or a local authority, or other marketable securities of a like nature; or

(iii) a housing financing company, that is to say, a company which carries on, as its principal business, the business of financing of acquisition or construction of houses, including acquisition or development of land in connection

therewith;

- (iv) a loan company, that is to say, a company
[not being a company referred to in
sub-clauses (i) to (iii)] which carries
on, as its principal business, the
business of providing finance, whether by
making loans or advances or otherwise;
- (v) a mutual benefit finance company, it is
to say, a company which carries on, as
its principal business, the business of
acceptance of deposits from its members
and which is declared by the Central
Government under section 620A of the
Companies Act, 1956 (1 of 1965) to be a
Nidhi or Mutual Benefit Society;
- (vi) a miscellaneous finance company, that is
to say, a company which carries on
exclusively, or almost exclusively, two
or more classes of business referred to
in the preceding sub-clauses."

Section 40(b) read as under :-

"40. Notwithstanding anything to the contrary in
sections 30 to 39, the following amounts shall
not be deducted in computing the income
chargeable under the head 'Profits and gains of
business or profession'-

(a)

(b) in the case of any firm, any payment of
interest, salary, bonus, commission or
remuneration made by the firm to any partner of
the firm.

Explanation 1.-Where interest is paid by a firm
to any partner of the firm who has also paid
interest to the firm, the amount of interest to
be disallowed under this clause shall be limited
to the amount by which the payment of interest by
the firm to the partner exceeds the payment of
interest by the partner to the firm.

Explanation 2-Where an individual is a partner in
a firm on behalf, or for the benefit, of any
other person (such partner and the other person

being hereinafter referred to as 'partner in a representative capacity' and 'person so represented' respectively),-

(i) interest paid by the firm to such individual or by such individual to the firm otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this clause;

(ii) interest paid by the firm to such individual or by such individual to the firm as partner in a representative capacity and interest paid by the firm to the person so represented or by the person so represented to the firm, shall be taken into account for the purposes of this clause.

Explanation 3.- Where an individual is a partner in a firm otherwise than as partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of this clause, if such interest is received by him on behalf, or for the benefit, of any other person."

5. It was contended on behalf of the assess before the Apex Court that interest payable by the partners to the firm pursuant to the agreement between the parties was of the same nature as that payable by the firm to the partners on the capital brought in by them. It was, therefore, urged that the interest paid to and received from a partner are both integral part of a method adopted by the partners for adjusting the division of profits and, in that sense, both payments partake the same character.

6. Referring to various decisions, the Honourable Supreme Court upheld the contention. It observed:

"We, accordingly, accept the submission of Shri Ramachandran on this point. In our opinion, where two or more transactions on which interest is paid to or received from the partner by the firm are shown to have the element of mutuality and are referable to the funds of the partnership

as such, there is no reason why section 40(b) should be so construed as to exclude in quantifying the interest on the basis of such mutuality. In such circumstances, the interest, if any, paid to a partner by the firm in excess of what is received from the partner could alone be excluded from deduction under section 40(b)."

5. In our opinion, the ratio laid down by the Apex Court in Keshavji Ravji & Company (supra) can be invoked by the assessee and the principle underlying section 40(b) (as then stood) would also apply to the provisions of section 40A(8) (as then stood). In our opinion, therefore, the Tribunal was right in allowing the appeal filed by the assessee.

6. For the foregoing reasons, in our opinion, the question referred to us deserves to be answered in affirmative, i.e. in favour of assessee and against revenue. Reference is accordingly disposed of. In the facts and circumstances, no order as to costs.

[C.K. THAKKAR, J.]

[A.L. DAVE, J.]

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